



1315 K STREET
MODESTO, CALIFORNIA 95354-0917
TELEPHONE (209) 527-6453
FAX (209) 527-0630

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David Ikari, Chief
Dairy Marketing Branch
1220 N Street
Sacramento, CA 95814

Dear Mr. Ikari:

Western United Dairymen would like to express grave concern over the recently released adjustments to the "audited" 2004 manufacturing cost study. The release of these updates on only labor and utility cost components undermines the soundness, the accuracy and the integrity of the "audited" cost studies. Adjusting only the utility and labor cost components capture only the changes in those cost components and fails to represent changes in any of the other costs or volume levels. This information is inaccurate and its presentation is extremely misleading.

Of particular concern is that although 2005 utility costs and 2005 labor costs are included in the recently released figures, the underlying cost study is based on 2004 volumes. So as these updates provide a more current picture of total costs, they do not accurately reflect changes in cost per pound. It is the cost per pound figure that is used by the industry and Department to determine appropriate manufacturing cost allowances.

As the Department is aware, production of most dairy products is up over 2004 levels. According to data in the California Dairy Information Bulletin 2005 California Cheddar and Monterey Jack cheese production is up 3.1% (25.7 million pounds) and butter production is up 5.7% (21.9 million pounds) over 2004 levels. Given the shift in production out of nonfat dry milk and into other dry milk powders, it is unclear as to the exact production change for powders. In any case, 2005 levels differ from those in 2004. Because the manufacturing cost numbers and manufacturing cost allowances are set on a dollar per pound basis, any increase in pounds (finished product) represented in the cost studies will drive down the dollar per pound manufacturing costs significantly. This is not reflected in the recent figures released by the Department as the volumes are not updated along with the costs. This is yet another serious flaw in publication of this misinformation.

"Cherry-picking" certain components of the studies inevitably distort fact. For instance, if the Department had instead developed "cherry-picked" data reflecting only increases in product volumes in 2005 spread over 2004 costs, the results, although still corrupt, lead to significantly different conclusions as shown below:

2004 Cheese Processing Costs with 2005 volume

Cost Groups	# of Plants	Reported Cost per lb with updates	Estimated Total Cost per lb	Estimated Volume in Group	Percent in Group	Estimated Total Cost
Low Cost	3	\$0.1770	\$0.1660	647,408,365	76.9%	\$107,483,812
High Cost	4	\$0.2021	\$0.1903	194,475,075	23.1%	\$37,004,125
Estimated 2005 volume				841,883,440		
Weighted Average per November cost study				\$0.1769		
Weighted Average with Sep utility & labor updates				\$0.1828		
Estimated Weighted Average with 2005 volume				\$0.1716		

2004 Butter Processing Costs with 2005 volume

Cost Groups	# of Plants	Reported Cost per lb with updates	Estimated Total Cost per lb	Estimated Volume in Group	Percent in Group	Estimated 2004Total Cost
Low Cost	4	\$0.1256	\$0.1156	306,413,024	75.2%	\$35,435,407
High Cost	4	\$0.1826	\$0.1683	101,051,104	24.8%	\$17,004,562
Estimated 2005 volume				407,464,128		
Weighted Average per November cost study				\$0.1368		
Weighted Average with Sep utility & labor updates				\$0.1396		
Estimated Weighted Average with 2005 volume				\$0.1287		

If the Department finds it necessary (which it should not) to release such misleading updates on certain cost categories then it is imperative to also include representative and updated plant volumes as it is obvious that the fixed and semi-variable costs included in the manufacturing cost data would decline if spread across a greater volume. These results would also be seriously flawed but perhaps these adjustments would mute the misinformation already developed. Of course if inappropriate time and effort is expended to conduct this analysis, we would argue that the other cost components should be updated as well. Where does this lead us? It is obvious that only a complete ***“audited”*** update of all cost components and volumes is appropriate to use when updating manufacturing cost allowances.

We recognize that the Department is attempting to provide service to its customers by responding to such requests for information. Unfortunately, dissemination of this requested data compromises the activities of your dedicated staff. We once again request that publication of misleading information such as this bearing the imprimatur of Secretary Kawamura be halted immediately.

We greatly appreciate your attention to this important matter and look forward to your response. Please call us with any questions you might have.

David Ikari, Chief
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Very truly yours,

A handwritten signature in black ink, appearing to read "Michael L. H. Marsh". The signature is fluid and cursive, with a large initial "M" and "L".

Michael L. H. Marsh, CPA
Chief Executive Officer

cc: Case Van Steyn, Western United Dairymen
Western United Dairymen Board of Directors
John Vlahos, Hanson, Bridgett, Marcus, Vlahos & Rudy, LLP
Jim Tillison, Alliance of Western Milk Producers
Rachel Kaldor, Dairy Institute of California
Bill Van Dam, Milk Producers Council